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September 20, 2004

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

RE: Supplemental Information in Support of Exchange Certification of Amendments to Option on Stock Index Futures Exercise Procedures. CME Submission #04-94.

Dear Ms. Webb:

On August 19, 2004, Chicago Mercantile Exchange Inc. ("CME" or "the Exchange") certified amendments to exercise procedures for its options on stock index futures contracts.[1] CME amended its rules to alter its options on stock index futures contracts from American style, which permits exercise at any time during the life of the option, to European style, which limits exercise to the termination of the option.

On September 15, 2004, Commission staff informally requested additional information regarding the manner in which exercise of such options into stock index futures contracts would be administered per the amended rules.

[1] CME Submission #04-82.

The amendments change the time at which an option may be exercised, they do not alter the process that is followed or the character of the instrument into which the option is exercised. As noted, option exercise will be constrained to the date of final settlement.[2] Option exercise creates a long (short) stock index futures position which is assigned to the buyer of a call (put) and a short (long) stock index futures contract assigned to the seller of a call (put).

In the case of "serial options," option exercise results in the assignment of a long/short pair of quarterly futures contracts to the buyer and seller of the option.[3] Thus, the exercise of a serial option expiring in, for example, January or February results in the creation of a pair of March futures contracts.

In the case of "quarterly options," option exercise results in the creation of a pair of quarterly futures contracts for the accounts of the parties to the option. Those futures contracts are subsequently settled in accordance with CME's procedures for settling futures contracts that remain open on the expiration of a contract. This process may be summarized in the context of a long quarterly call option as follows …

- Assume the call falls in-the-money and is exercised: the long call option is exercised into a long stock index futures position that is priced at the strike of the option. The futures position appears on CME Trade Register File CPM 591RTH that business day. That position is posted at the option strike price and marked-to-market (MTM) to the settlement price.

- On the subsequent business day, the long stock index futures position is settled in cash and stricken from the Trade Register

Please note that the procedures described above have been applied in the context of CME flex options on stock index futures since they were introduced in April 1995 under the leadership of then CME President William Brodsky. Flex options are offered in both an American style and European style. Market participants frequently trade European style flex options with expiration dates identical to the Final Settlement Date of the underlying stock index futures contract.

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[2] Note that Regulation Section 33.4(b)(2) requires exchanges seeking designation as a contract market for the trading of commodity options to adopt rules which, amongst other requirements, "[p]rescribe an expiration date of the option … where the underlying futures contract is cash settled, the option may expire simultaneously with the expiration of the futures contract." Of course, CME is not proposing to amend its exercise date(s) not the option expiration date.

[3] "Serial options" are those that expire in January, February, April, May, July, August, October or November. Serial options may be distinguished from "quarterly options" expiring in March, June, September or December.

CME's flex option Rules were submitted to the Commission in correspondence dated November 11, 1994 through February 23, 1995. The Commission approved those Rules by correspondence dated April 14, 1995 and the Rules were deployed by the Exchange shortly thereafter. The Commission's correspondence of April 14th acknowledged that flex options "(1) are American or European exercise style, (2) expire on any Exchange business day following the initial listing of an underlying futures contract though, typically, the last trading day of the last standard option on that futures contract month to expire, (3) are underlaid by any futures contract month available for trading ..."

The Securities and Exchange Commission ("SEC") in a letter dated March 31, 1995 addressed to the Commission indicated it had reviewed CME's proposed amendments and "does not object to the CME's proposal." [4]

If you require any additional information regarding this matter, please do not hesitate to contact me at 312-466-7469 or via e-mail at jlab@cme.com. Please reference our CME Submission #04-94 on all future correspondence regarding this notification.

Sincerely,

John W. Labuszewski, Director
Research & Product Development

CC: Mr. Thomas M. Leahy and Mr. Steven B. Benton
CFTC Division of Market Oversight, Product Review & Analysis Section

[4] Letter dated March 31, 1995 from Brandon Becker, Director, Division of Market Regulation, Securities and Exchange Commission to Stephen A. Sherrod, Chief Financial Instruments Unit, Division of Economic Analysis, Commodity Futures Trading Commission.